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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1935.

No. 238.

Guy T. Helvering, Commissioner of Internal Revenue,

Petitioner,

vs.

E. E. Combs and Edward Everett, Trustees of E. E. Combs Well No. 2, Express Trust,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

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TOPICAL INDEX.

	PAGE
Issue involved	4
The facts	4
Reasons why the writ prayed for by petitioner should be denied	8

TABLE OF AUTHORITIES CITED.

CASES.	PAGE
Burk-Waggoner Oil Ass'n v. Hopkins, 269 U. S. 110, 46 S. Ct. 48	8
Coleman-Gilbert Associates v. Commissioner, 76 F. (2d) 191	9
Commissioner v. Brouillard, 70 F. (2d) 154	9
Commissioner v. Kelley, 74 F. (2d) 71	9
Hecht v. Malley, 265 U. S. 144, 44 S. Ct. 462	8
Helvering v. Pryor & Lockhart Development Co., 293 U. S. 574, 55 S. Ct. 85	9
Lucas v. Extension Oil Company, 47 F. (2d) 65	9
Morrissey v. Commissioner, 74 F. (2d) 803	10
Reinecke v. Kaempfer, 72 F. (2d) 469, 55 S. Ct. 405	9
Swanson v. Commissioner, 76 F. (2d) 651	9

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RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Respondents herein respectfully submit that the petition for a writ of certiorari heretofore filed should be denied because:

1. There is no real confusion among the various Circuit Courts with respect to the issue herein involved, namely, *when is a trust taxable as an association.*

2. There is no real conflict between the various Circuit Courts as to the law properly applicable to

the issue above referred to. At most, said Circuit Courts differ only in the results arrived at from the application of admittedly proper rules of law to particular sets of facts. Such differences *in result* are frequent and inevitable.

3. The Circuit Court of Appeals for the Ninth Circuit was correct in affirming the decision of the United States Board of Tax Appeals holding that the respondents herein were not taxable as an association for the calendar years 1925 and 1926.

Issue Involved.

Whether the express trust of which the respondents herein were trustees constituted an association taxable as a corporation for the calendar years 1925 and 1926.

Before the Circuit Court of Appeals petitioner herein contended that in order to render said trust so taxable *it was only necessary that it be engaged in business* as that term is ordinarily understood. The lower court in finding that said trust was not taxable as an association held that in addition to doing business *it was essential that it be organized and operated along the forms, modes, and methods of a corporation, which situation did not here exist.*

The Facts.

While the facts as stated by petitioner herein are substantially correct, we prefer to restate them in a slightly different fashion, employing in general for that purpose the statement of facts appearing in respondents' brief before the Circuit Court of Appeals:

1. The Hub Oil Company was the owner of a certain oil lease subject to a royalty reserved to the lessor. [R. 35, 40.]

2. One Combs, acting apparently with one Everett, desired to develop the property in conjunction with the Hub Oil Company and one Bailes. [R. 37-41.]

3. Prior to the creation of the trust herein involved Combs and Everett entered into an agreement with Bailes whereby Bailes was to furnish drilling equipment, drill pipe, drilling materials, and *to superintend the drilling and production operations until the well should be on commercial production.* For this Bailes was to receive 12% of the gross proceeds of the well. [R. 37.]

4. The Hub Oil Company was to furnish a derrick, boilers, gas trap, etc. In case a producing well was brought in, the Hub Oil Company was to be paid the fair value of the property furnished. In case the project was unsuccessful, the Hub Oil Company had the right to remove the equipment from the property. As a matter of fact, from production the Hub Oil Company did receive for the equipment $15,000. In addition the company reserved a percentage of the future gross production of the well. [R. 35, 37.]

5. All the elements necessary in order to complete a producing well were thus provided for, except the cost of labor, casing, and incidentals. These were to be furnished in one or both of two ways:

(a) Percentage interests in future gross production of the well less *pro rata* expense deductions were to be sold. [R. 38.]

(b) Such portion of the percentage of gross production retained by Combs personally as might be

necessary was to be later sold by Combs in case the proceeds of the first sales of beneficial interests were insufficient. The proceeds of such sales were to be used for trust purposes and were not to revert to Combs personally. In effect, Combs was required to dispose of his entire personal interest and donate the proceeds back if necessary in order to prove the lease. [R. 39, 40.]

6. Based upon the above, the trust instrument in question was drafted and signed. It was simple in the extreme. There was no name, no seal, no office, no principal place of business, no provision for removing or replacing trustees, no meeting of trustees or beneficiaries was provided for. The beneficiaries never held a meeting of any kind. There were no officers and no board of directors. [R. 35, 41.]

7. The instrument provided that the Hub Oil Company and Bailes should receive percentages of gross production, whereas all those investing money received percentages based upon net production. Hub Oil and Bailes were not beneficiaries in the same sense as were those who put in cash, but were the owners of overriding royalties. They apparently participated, however, in the proceeds of the sale of the lease. The Hub Oil Company was also a creditor in case a producing well was brought in. [R. 37, 41.]

8. A producing well was brought in in 1925. The *entire* proceeds of production, after the payment of expenses, were distributed to the various beneficiaries. [R. 40.] No depreciation or depletion reserve was ever set up or maintained.

9. Whether or not certificates of beneficial interests were ever issued to the Hub Oil Company and/or Bailes does not appear from the record.

10. But one lease was acquired and but one well was drilled. The trust indenture provided for but one lease and one well. [R. 36, 41.]

11. The proceeds of production were paid to a bank and were by it actually handled and disbursed. [R. 40.]

12. According to the record the beneficiaries were totally inactive and neither exercised nor had the power to exercise any sort of control over the trust.

13. The record does not show what the activities of the trustees actually were. It may be assumed that they were slight, as Bailes was required to drill the well and superintend all operations until the well was on a commercial production basis. *There was apparently nothing done or to be done by the trustees except to furnish the money for the drilling operation and to later negotiate, in conjunction with other percentage owners, the sale of the lease.*

Such activities as were indulged in by the trustees are set forth in the "Statement of Evidence." [R. 34 to 36.]

14. In 1926 the lease was sold and the gross proceeds distributed. While the record does not specifically indicate either way, the presumption seems inescapable that the proceeds were distributed *pro rata* to all interested parties, including the Hub Oil Company and Bailes. Immediately after the sale the trust was terminated. [R. 35.]

15. No money was ever borrowed in behalf of the trust and no activities other than those already detailed were ever engaged in.

Reasons Why the Writ Prayed for by Petitioner Should Be Denied.

1. In his petition the petitioner alleges the existence of much confusion in the cases involving the above-named issue. If by confusion petitioner means that the decided cases covering this subject are not easily reconcilable *in result*, we agree. Such confusion, however, arises, we submit, from the application of reasonably uniform rules of law to different and varied sets of facts. It cannot be expected under such circumstances that different courts, even though applying the same rules of law, would reach identical conclusions.

Petitioner has failed to point out any real confusion as to the rules of law applicable to the issue with which we are here concerned. Confusion appears to petitioner to exist because he has refused to accept the definition of an association as adopted by this Court in *Hecht v. Malley*, 265 U. S. 144, 44 S. Ct. 462 (1924), and *Burk-Waggoner Oil Ass'n v. Hopkins*, 269 U. S. 110, 46 S. Ct. 48 (1925). In both of the above cases the Court held that an unincorporated body did not constitute an association taxable as a corporation unless in addition to doing business it was organized and operated along the forms and methods used by incorporated bodies.

It may be that petitioner desires this Court to so elaborate its views on this subject that hereafter lower tribunals may without difficulty reach a correct result in the many cases coming before them. If this is possible we would welcome it. We do not believe that this Court will attempt so to do.

2. There is no real conflict with respect to the issue herein involved between various Circuit Courts of Appeal.

The various Circuit Courts of Appeal in the United States have practically uniformly adopted the dual test already referred to as to what constitutes an association, namely, (1) doing business, and (2) organization and operation along the forms, modes, and methods ordinarily employed by corporations. Whatever differences which may have originally existed as to the legal principles properly applicable have now been virtually eliminated. This dual test has been applied by various Circuit Courts in the following recent cases: *Lucas v. Extension Oil Company*, 47 F. (2d) 65 (1931), Fifth Circuit; *Commissioner v. Brouillard*, 70 F. (2d) 154 (1934), Tenth Circuit; certiorari denied sub. nom. *Helvering v. Pryor & Lockhart Development Co.*, 293 U. S. 574, 55 S. Ct. 85 (1934); *Reinecke v. Kaempfer*, 72 F. (2d) 469 (1934), Seventh Circuit; certiorari denied January 21, 1935, 55 S. Ct. 405; *Commissioner v. Kelley*, 74 F. (2d) 71 (1934), First Circuit; also *Coleman-Gilbert Associates v. Commissioner*, 76 F. (2d) 191 (1935), First Circuit; certiorari applied for May 27, 1935, Nos. 78 and 79, October Term, 1935.

It is alleged by the petitioner herein that the decision of the Ninth Circuit Court of Appeals in the instant case is in substantial conflict with the decision of the Circuit Court of Appeals for the Seventh Circuit in *Swanson v. Commissioner*, 76 F. (2d) 651 (1935); certiorari applied for June 7, 1935, No. 108. We deny the conflict alleged by petitioner. It is true that the two Circuit Courts of Appeal reach different conclusions. It is also true, however, that different sets of facts were involved. It is submitted, however that *each court applied the same legal principles to the solution of the problem before it.*

Petitioner asserts that the decisions of the Circuit Court of Appeals for the Ninth Circuit in the instant case is in conflict with its prior decision in *Morrissey v. Commissioner*, 74 F. (2d) 803 (1934); taxpayer's petition for certiorari granted May 13, 1935, No. 17, October Term, 1935. With petitioner's contention in this respect we agree, although the facts involved in the two cases are essentially different. While we do not assert that the decision finally arrived at by the Ninth Circuit Court of Appeals in the *Morrissey* case was erroneous, we do believe the Court erred in failing to consider whether or not the trust in that case operated along the forms, modes, and methods ordinarily employed by corporations. The fact that the Court in that case failed to apply the proper legal tests to the problem before it constitutes the reason, we assume, why this Court granted certiorari. It does not follow, however, that the Ninth Circuit Court's subsequent decision in the instant case *in which that test was applied*, was wrong and that certiorari is hence here justified.

Wherefore, it is respectfully submitted that the petition herein prayed for should be denied.

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August, 1935.